

COMMENTS ON UNITED STATES DEPARTMENT OF ENERGY
LOAN GUARANTY PROPOSED RULEMAKING PURSUANT TO
RIN 1901-AB21

Submitted by WMPI PTY., LLC,
Developer of Coal-to-Liquid Fuels Project in Schuylkill County, Pennsylvania

Dated: June 12, 2007

Introduction

WMPI Pty., LLC is providing these comments and responding to proposed rule pursuant to RIN 1901-AB21 as a pre-applicant under the Federal Loan Guarantees For Projects That Employ Innovative Technologies in Support of the Advanced Energy Initiative program (Solicitation Number: DE-PS01-06LG00001) dated August 2006. As stated in the proposed rule, “In order to ensure that the Department complies with the CR but does not prejudice Pre-Applicants who responded to the first Title XVII solicitation, DOE proposes to specify, by regulation, that today’s proposed rule, when final, shall not apply to the Pre-Applicants, Applications, Conditional Commitments, and Loan Guarantee Agreements pursuant to the August 2006 solicitation.”

While appreciative of the opportunity to benefit from a Federal Loan Guaranty, and respectful of the time and effort devoted to the preparation of the Solicitation, WMPI Pty., LLC (“WMPT”) wishes to comment on several areas where the Solicitation deviates from the meaning and intent of the Energy Policy Act of 2005. As Congress has expressed its intention to benefit the development of projects such as WMPI’s, the Solicitation should not outline an implementation of the program which would subvert Congress’ intention, or which imposes impractical constraints in light of reasonably anticipated project financing market considerations.

1. Federal Credit Reform Act of 1990 Guaranty Appropriation

The preamble to the Solicitation and Appendix B (pp. 4-5) indicate that obtaining requisite Congressional appropriation authorization is required under the Federal Credit Reform Act of 1990 ("FCRA") notwithstanding the fact that Title XVII of the Energy Policy Act allows for the cost of a loan guaranty, as defined in 2 U.S.C. 661a(5)(C), to be paid by the recipient.

WMPI does not believe that the FCRA appropriation requirement applies to its project, for the following reasons.

The appropriation requirement of the Federal Credit Reform Act is found in Section 661c(b), and reads as follows:

"(b) Appropriations required.

Notwithstanding any other provision of law, new direct loan obligations may be incurred and new loan guarantee commitments may be made for fiscal year 1992 and thereafter only to the extent that -

- (1) appropriations of budget authority to cover their costs are made in advance;
- (2) a limitation on the use of funds otherwise available for the cost of a direct loan or loan guaranty program is enacted; or
- (3) authority is otherwise provided in appropriation Acts."

This provision is generally applicable in a circumstance where it is the government's funds which are being set aside for the subsidy cost. While a strict reading of the introductory

language of the appropriation requirement would appear to indicate that it always applies, it does not make sense to apply it where the project is using its own funds.

More specifically with respect to WMPI's project, its ability to fund its own Subsidy Cost, including using its CCPI award funds, is specifically set forth in Section 1703(c)(4) of the Energy Policy Act, as follows:

“(4) LIQUEFACTION PROJECT. - Notwithstanding any other provision of law, funds awarded under the Clean Coal Power Initiative under Subtitle A of Title IV for coal-to-oil liquefaction projects may be used to finance the cost of loan guarantees for projects awarded such funds.”

In order to make a reasonable construction of both Section 1703(c)(4) of the Energy Policy Act and 2 U.S.C. §661c(b), both of which begin with the phrase “Notwithstanding any other provision of law” - which would seem to make reading them together somewhat circular - we submit that the appropriate recognition to be given to the provision of the Energy Policy Act is that it either constitutes a limitation of funds otherwise available for the cost of a loan guaranty program as contemplated under §661c(b)(2), or is the authority otherwise provided in an appropriation act as referenced in 2 U.S.C. §661c(b)(3).

Also, to the extent DOE perceives there to be any conflict between the FCRA and the Energy Policy Act, general principles of statutory construction would provide for the more recent and more specific statute - here, the Energy Policy Act - to prevail.

It was certainly the intention of Pennsylvania's Senators Specter and Santorum, who were in large part responsible for the language of the Energy Policy Act authorizing the utilization of CCPI funds by WMPI to pay its Subsidy Cost, that the Energy Policy Act would constitute both authorization of the guaranty, and an appropriation (or a substitute for appropriation) of the funds necessary for the implementation of the guaranty, such that there would be no additional legislation required, such as another appropriation under the FCRA.

As to the WMPI project, there should be no limitation upon DOE entering into a binding loan guaranty agreement if the project successfully proceeds through the pre-application and application phases. In short, no further appropriation authority should be required.

2. Payment of Subsidy Cost with Other Federal Funds

Section C of the Description section of the Solicitation (p. 3) indicates, with reference to the Subsidy Cost, "The Borrower may not finance this payment through a loan made or guaranteed by the Federal government."

As indicated above, the WMPI project is specifically authorized to use its CCPI money by virtue of the language in §1703(c)(4) of the Energy Policy Act. DOE's Solicitation cannot alter Congress' intent by saying that the project is not allowed to use those funds for that purpose.

3. Exclusion of Subsidy Cost from Project Costs.

Excluding the Subsidy Cost and the Administrative Cost from the Project Costs (Appendix B, p. 6) may have a negative impact on the overall success of the proposed financing. Assume a hypothetical project size of \$1,000,000,000, with the federal government guaranteeing 80% of that, or \$800,000,000. At a 10% subsidy cost, that would be \$80,000,000. If that \$80,000,000 has to be excluded from the Project Costs, that has much more than an incidental impact on the financing. To the extent that subordinated debt would be necessary to fund the Subsidy Cost, the comments later in this paper concerning the complexity and cost which the Solicitation imposes upon subordinated debt should be given serious consideration.

Neither the Energy Policy Act nor the FCRA requires the exclusion of the Subsidy Cost and Administrative Cost from the Project Costs for purposes of determining the amount of the guarantee.

4. 80% Limitation.

WMPI acknowledges that the Energy Policy Act imposes an 80% limitation on the amount of total Project Costs which the government will guaranty. However, the manner in which that is proposed to be implemented under the Solicitation imposes constraints that will make the financing difficult and/or more expensive than necessary. At page 9 of Appendix B, under the Discussion of the Guidelines section, DOE states its preference that "DOE not guarantee more than 80% of the total face value of any single debt instrument." (Emphasis

added). This is more restrictive than required by the Energy Policy Act, and would be detrimental to financing projects successfully.

For ease of presentation of the issue, assume that a project were being 100% financed, without equity.¹ The likely structure of the financing would be that there would be two notes, or two series of bonds, issued. The first would be for 80% of the project cost, with the benefit of the federal guarantee. The second would be for the 20% that is not supported by the guarantee. However, if that were the conceptual framework for the financing, the quoted language of the Solicitation would apply such that the guarantee would secure only 80% of the 80%, or 64% of the overall project. A project would then be compelled to raise another 16% of its Project Costs either through subordinated debt or equity. Either alternative would make it tougher to complete a project, while Congress' instructions are that the projects be incentivized. If that 16% were to come from subordinated debt, the other problems referenced later in the next section of these comments would apply to make the situation an acute problem.

5. DOE Position Regarding Lien Priority.

Under the heading Discussion of the Guidelines on page 9 of Appendix B, the following language appears: "This statutory provision requires DOE to possess a first lien priority in the assets of the project and other collateral security pledged. Because DOE is not permitted by Title

¹We recognize that elsewhere in the Solicitation the extent of equity is referenced as a factor that will be material to the competitive evaluation of proposals, but set that aside for this comment.

XVII to adopt a pari passu financing structure, any holders of non-guaranteed debt have a subordinate claim to DOE in the event of default, and will not be able to recover on their debt until DOE's claim is paid in full." The language that is referred to by the reference "This statutory provision" is Section 1702(g)(2)(B) of the Energy Policy Act which requires that "The right, of the Secretary, with respect to any property acquired pursuant to a guaranty or related agreements, shall be superior to the rights of any other person with respect to the property."

We respectfully suggest that this provision of the Solicitation too strictly applies the language of the Energy Policy Act, in a manner which again would be detrimental to Congress' intention to see projects financed and placed into operation.

We can agree with the language of the Solicitation as it pertains to DOE's rights in the event that DOE has paid out on a guarantee. However, it is not required that the Energy Policy Act be interpreted to forbid shared pari passu first liens on the project assets for the benefit of subordinated debt holders. If subordinated debt holders perceive the requirement of the Solicitation to be that they are deeply subordinated, or effectively unsecured, any such subordinated debt will be very difficult to place, and prohibitively expensive. While DOE, particularly if it becomes necessary to pay out on the guarantee, should have the greatest protection relative to the assets of the project, DOE should not compel a structure in which the cost of the subordinated debt is so high that a default occurs which could otherwise be avoided (if the cost of the subordinated debt were more in keeping with market rates based on a pari

passu lien position).² It is not in the government's best interest, even if the government effectively has the most senior rights in the collateral, to precipitate a default unnecessarily.

A closer reading of the Energy Policy Act indicates that the required collateral position for the government is found in Section 1702(d)(3) "SUBORDINATION. - The obligation shall be subject to the condition that the obligation is not subordinate to other financing." (Emphasis added). This statutory provision which governs the required lien position for DOE does not forbid a pari passu position, it merely prohibits the government from being in the junior position.

Section 1703(g)(2)(B), cited in the Solicitation, relates to the rights of the Secretary, and applies to a specific point in the life of the project. The lead in to §1702(g)(2)(A) is "If the Secretary makes a payment...". The restrictions of this provision do not apply unless and until a payment is made under the guarantee. Thus the reference in §1702(g)(2)(B) with respect to any property acquired pursuant to a guarantee and requiring that the Secretary's rights be superior, should be read to mean the Secretary only has to have the superior rights subsequent to making a payout on a guarantee. At that point, the Secretary is subrogated to the rights of whatever lender was provided the benefit of the guarantee and has received payment from the Department.

²Hypothesize a contrast between subordinated debt priced at 8% interest per annum and subordinated debt priced at 12% per annum. If the amount of subordinated debt is \$200,000,000, the difference in interest rate in the first year alone has an impact on the project of \$8,000,000. That is not a trivial impact.

WMPI believes the following structure fairly meets the provisions of the Energy Policy Act, and is more conducive to a placement of debt that will not require a significant premium in interest rate on the subordinated debt:

% The first layer of debt, which has the benefit of the federal guarantee, and any subordinated debt can share a pari passu first position lien on project assets.

% There would be an intercreditor agreement under which a collateral agent would be appointed to serve for the benefit of both the Department of Energy and the issuer(s) of any subordinated debt. That agreement would provide a tiered sequence of payments, typically referred to as a “waterfall of accounts”, with those payments clearly prioritized in a manner consistent with §1703(g)(2)(B). By way of example, assume that Bank A lends the project 80% of the project cost with the benefit of the Federal guarantee and Bank B lends 20% as subordinated debt.³ The intercreditor and collateral agency agreement would specifically provide that revenue received each month would be devoted to payments first to Bank A, and only to the extent that there were funds available above and beyond the

³For sake of simplicity, this example leaves out the requirement of funding operating expenses which, in the absence of a default, would presumably be the top line, and also ignores equity, and the issue of what costs may be excluded from Project Costs. Also, we refer to Bank A and Bank B despite the more likely scenario being that there would be bondholders.

required payment to Bank A would there be a payment to Bank B. If there were a default to Bank A, and DOE makes a payment pursuant to its guarantee to Bank A, DOE then steps into the position of Bank A and receives all payments until DOE has been made whole. That would comply with §1703(g)(2)(B), and most of the wording in the Solicitation, but would not impose upon a project (at the time of financing) a structure that would be so disadvantageous to the holders of subordinated debt as to make the subordinated debt prohibitively expensive.

6. Prohibition on Separate Sale of Guaranteed Debt and Non-Guaranteed Debt.

The Solicitation prevents the “stripping” of the guaranteed debt and its sale in the secondary market separate from the unsecured debt. Appendix B, p. 10. We believe that is based on an assumption of a model of bank financing that is akin to programs such as the USDA Loan Guaranty Program. In a capital markets financing, with Project Costs of the magnitude of those such as for WMPI, the appropriate level of flexibility in structuring and marketing the financing makes it appropriate to have the flexibility to sell the guaranteed debt and the non-guaranteed debt separately.

7. Definition of Lender.

While the definition of the term “Lender” on p. 15 of Appendix B is broad, the language in the last paragraph of p. 10 appears modeled upon a USDA loan guarantee type program in which a local commercial bank funds the loan, assumes the risk of the unguaranteed portion of the loan, and assumes reporting responsibilities to the governmental guarantor. WMPI and projects of its size will much more likely be funded through a public offering of securities than by a commercial bank loan.

There are a number of requirements in Appendix B that contemplate a bank financing and would be difficult to adapt to a capital market financing. As the Energy Policy Act does not express a preference for bank financing or a prohibition of capital market financing, these requirements should be restructured to accommodate a wider range of financing alternatives. These requirements include:

- (i) Requirements for Participating Lenders. On p. 10 of Appendix B, DOE outlines certain eligibility requirements for participating Lenders to “ensure that the Lender has the financial wherewithal and appropriate experience and expertise to meet its fiduciary obligations in connection with the debt guaranteed by DOE.” DOE also expects the Lender to “exercise a high level of care and diligence in the establishment and enforcement of the conditions to all loan disbursements and Borrower covenants, provided for in the loan agreement and related documents, throughout the term of the loan.” pp. 10-11. The Lender is expected to “diligently perform its duties in the servicing and collection of the loan as well as in ensuring

that the collateral package securing the loan remains uncompromised” and the lender is expected to “provide regular, periodic financial reports on the status and condition of the loan, consistent with the terms of the Loan Guarantee Agreement.”

For a bond financing, there is no single lender but a group of bondholders. The requirements laid out by DOE are typically performed by a combination of the Underwriters, the Trustee and the Borrower through a covenant to bondholders to provide periodic updated disclosure.

- (ii) Pre-Application Requirements. Appendix B Part III C outlines requirements of a Pre-Application including #5 on p. 19, a commitment letter from an Eligible Lender. Unlike a bank financing, a bond financing will have many bondholders and a commitment cannot be made prior to the bond sale. The underwriters for the financing would be able to provide a letter representing that they believe a financing could be completed for the project, but such a letter would not be an underwriting commitment.
- (iii) Application Requirements. Appendix B Part III F outlines requirements of an Application including #14 on p. 23, “a copy of all loan documents that Borrower and Lender will sign if the Application for a loan guarantee is approved, containing all of the terms and conditions of the loan or other debt obligation to be

guaranteed, including the proposed amount of the loan, interest charges, repayment position, principal repayment schedules, fees, pre-payment and late payment penalties and cure rights.”

A bond financing would have an Indenture that defines repayment position and cure rights, however, the interest charges and principal repayment schedules could not be finalized in advance of the bond sale.

Requirement #21 on p. 24 is “a preliminary credit assessment for the project without a loan guarantee from a nationally recognized rating agency.” This could be difficult to obtain for either a bank or a capital market financing at the time of the Application. A requirement for an underlying project rating as a condition of the financial closing would be more feasible.

Requirement #26 on p. 25 is a “Written affirmation from an officer of the Lender confirming that the Lender is an Eligible Lender in good standing with DOE’s and other agencies’ loan guarantee programs.” As outlined above, a bond financing would not have a Lender but instead would have bondholders.